Poverty and a Basic Income Grant

Six questions about a BIG

THE GROWTH AGENDA
Priorities for mass employment and inclusion

CDE

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Series Editor: Ann Bernstein

Photo credit: Informal shack settlement in Cape Town, South Africa, by Nic Bothma/EPA

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Introduction

A spectre haunts South Africa's public finances: the possible introduction of a basic income grant (BIG) – a monthly cash transfer to all qualifying beneficiaries. The precise cost of the proposal is unclear because proponents of a BIG differ on critical questions of how much the grant should be and how many people ought to receive it.

This report makes the case that, while horrific levels of unemployment and poverty in South Africa, combined with slow economic and employment growth, make calls for a BIG understandable, a BIG that is large enough to make a meaningful impact on poverty would (at best) slow economic growth and may even lead to fiscal and financial crisis. The bottom line is that public spending in South Africa already exceeds the bounds of what is affordable, so adding a large new spending commitment will make matters worse.

The report is framed around six questions, each of which stands alone, although we would recommend reading them in order:

- Why is South Africa thinking about a BIG now?
- What do proponents of a BIG say they want?
- Doesn't South Africa already do a lot of redistribution?
- Can we afford a BIG?
- Will a BIG induce more rapid economic growth?
- What alternatives exist for reducing poverty?

There are no easy answers to South Africa's socio-economic challenges. The truth is that we have dug ourselves into a deep hole, one from which we can extricate ourselves only with sustained economic growth that is as rapid and as labour-intensive as possible. A BIG, while superficially appealing, would significantly undermine the quest for faster growth by making our public finances even more unsustainable. Magical thinking about the benefits of a BIG that ignores the costs and the risks does more harm than good.

Question One: Why is SA thinking about instituting a basic income grant now?

"South Africa is drowning in poverty."

South Africa is drowning in poverty: few if any countries at our level of development have rates of poverty as high as ours. The last official estimate of the poverty rate in 2014 estimated that almost 56 per cent of South Africans were poor, with poverty defined as having an income of less than R992 per month. Since then, it is reasonable to conclude that poverty has only worsened because, even before the economic devastation of the last two years of Covid-19 and the various disasters in KwaZulu-Natal, the economy had been growing more slowly than the population, and job creation had been growing even more slowly still.

Real-time tracking of poverty is not possible, so there are no figures that are completely up to date, but a last wave of the NIDS-CRAM survey, which was in the field in April and May 2021, estimated that 14 per cent of South Africa's children (about three million) lived in households in which at least one person had experienced hunger in the previous week.

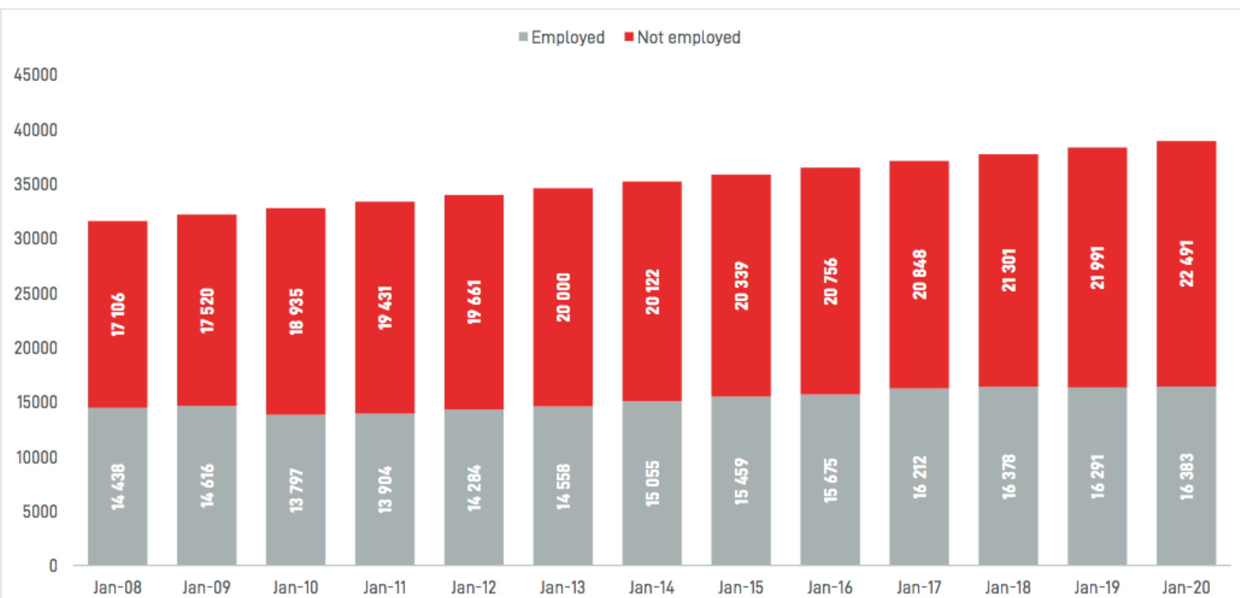
That figure was 40 per cent higher than StatsSA's 2018 estimate for children in hunger-affected households, but, given the violence of June 2021 and the floods of April 2022, it probably understates current realities.

"Only 42 per cent of working age South Africans had paid employment compared to a norm of around 60 per cent in the developing world."

It is figures like this that underpin the realities of a recent *Daily Maverick* story (29 March 2022), that opened with this chilling sentence: "In the past 15 months, 14 children under the age of five starved to death in Nelson Mandela Bay and another 216 new cases of severe acute malnutrition were confirmed in the Eastern Cape's biggest metro," and which also reported that "Last week, the Eastern Cape Department of Health confirmed that seven children had died of severe acute malnutrition in Butterworth during the first two months of this year."

These datapoints reflect the stark reality of poverty in South Africa, the cause of which lies in South Africa's exceptionally high levels of unemployment, which, while measured somewhat imprecisely, is in the order of 30 to 40 per cent of the working age population, depending on how "unemployment" is defined and depending on what allowances are made for the difficulties of conducting household surveys during the pandemic. Nevertheless, even before Covid-19, an astonishing number of South African adults had no work: in the first quarter of 2020, only 42 per cent (16.4 million) of the 39.9 million working age South Africans had paid employment of any kind, a figure that was down from 46 per cent in 2008. Compared to a norm of around 60 per cent in the developing world, these figures reflect the increasingly catastrophic performance of South Africa's labour market over the past two generations. Between 2008 and 2020, the number of working age adults had increased at an annual average rate of 1.8 per cent, the number of employed adults had increased at the rate of 1.1 per cent per year, and the number of adults who were not working had climbed by 2.3 per cent a year (Figure 1).

Figure 1: Working age population, and adults in thousands with and without employment: 2008 to 2020



Source: StatsSA, Quarterly Labour Force Survey

"The ruling party is in desperate need for something positive that it can show the electorate."

Nor is unemployment the only symptom of the labour market's failures: large proportions of those who do have jobs earn wages that are too low to lift their households out of poverty unless there is someone else in the household who is also earning an income. Many low-wage workers live in households in which there are either no other adults or there are no other adults who earn an income. The result is that even households in which someone works may be poor because incomes have to be shared with other unemployed adults and with their dependents.

All of which reflects the fact that, while South Africa has a relatively extensive social safety net by the standards of the developing world (see below), there is no meaningful income support for unemployed able-bodied adults. Indeed, until the social relief of distress grant was expanded to provide R350 per month to large numbers of people during Covid-19, South Africa's grants system was dominated by grants paid to pensioners and to children in poor households. Able-bodied, working age adults were not eligible for any of these.

Thus, the existence of extremely high levels of poverty driven by catastrophically high unemployment, combined with the absence of any social security for unemployed adults is the principal reason why a BIG is on the agenda. Like other grants, it would provide income directly to eligible people every month (though precisely how much this would be and precisely who would be eligible is unclear and highly contested – see below).

Providing direct cash payments to poor households will reduce the poverty of their members: since poverty is mostly a function of a lack of income, cash transfers to poor households will make them less poor.[1] However caution is required in saying that a BIG would inevitably reduce poverty. As will be discussed below, a BIG's impact on poverty depends heavily on its impact on the macroeconomy and how this affects trends in employment and poverty.

The desire to address increased poverty is not the sole reason why a BIG is now more firmly on the agenda than it has ever been before. Two other factors are relevant:

> **The apparent success, and repeated extension, of the social relief of distress grant**
> The imposition of tough lockdown measures in response to Covid-19 meant that government had to step in to assist households whose incomes would be compromised. After some prevarication, eligibility rules for the social relief of distress (SRD) grant were expanded dramatically, and systems were put in place to allow people to apply for it. In principle, these were supposed to ensure that only those without a source of income would be eligible, but in practice it was all but impossible to do this. Given this, the fact that "only" nine million people registered for the SRD grant is somewhat surprising and probably should not be interpreted as an indication of the number of people in need as it will include people who would not meet the eligibility requirements of the means test, and will exclude (probably many more) who would meet it.
>
> The fact that the SRD grant has been extended repeatedly, makes it difficult to withdraw. Add to that the fact that the violence of July 2021 was fuelled by poverty-induced desperation, and it is understandable that many people – including much of the ruling party – have concluded that it is risky, from both a political and a national security point of view, to contemplate anything other than making a grant of this kind permanent.

The governing party's need to shore up electoral support

A key reason that the BIG is back on the table so firmly is that the ruling party is in desperate need for something positive that it can show the electorate. Given the abject failure of many of its policies to achieve their stated goals, the deepening suspicion and cynicism with which its promises are greeted, and the increased competition it faces for votes from a variety of opposition parties, the ANC needs to be able to point to something as a success. A new and permanent grant to millions of poor people is seen by the party and others as a critical strategy for retaining electoral appeal.

"Most proposals from civil society organisations favour a grant that would cost in the hundreds of billions of rands a year."

Question Two: What do proponents of a BIG say they want?

Among proponents of a BIG, there is no single vision of the two most important parameters for a grant: how many people would be eligible, and what would be its value. There is, however, a general sense that the BIG needs to be as generous as possible, covering as many poor people as possible and providing them with as much income as possible. In a 2021 report, Intellidex compiled a simple table setting out the various combinations of possible eligibility rules (which determine the number of beneficiaries) and the potential value of grants that had been proffered by one or another of a BIG's proponents (Table 1). It showed that estimates of total cost of a BIG varied between R20 billion a year (about 0.2% of GDP) and R2.5 trillion a year (40% of GDP), which represents an exceptionally wide range of possible outcomes. What, then, is actually being proposed?

Table 1: Estimates of the cost (in R billions) of a BIG with different policy parameters

	Eligible pop.	R260pm	R350pm	R460pm	R585pm	R840pm	R1 268pm	R1 980pm	R2 500pm	R3 500pm
Universal	**60.1m**	R188	R252	R332	R422	R606	R914	R1 428	R1 803	R2 524
Universal (adults only)	**38.4m**	R120	R161	R212	R270	R387	R584	R912	R1 152	R1 613
Adults under upper-bound poverty line (R1268 pm)	**18.3m**	R57	R77	R101	R129	R185	R279	R435	R549	R769
All adults bet. 19 and 59	**33m**	R103	R139	R182	R232	R333	R502	R784	R990	R1 386
Adults w/o formal employment	**22.3m**	R70	R94	R123	R157	R225	R339	R530	R669	R937
Adults under lower-bound poverty line (R840pm)	**13.2m**	R41	R55	R73	R93	R133	R201	R314	R396	R554
Adults w/o any employment	**17.3m**	R54	R73	R95	R121	R174	R263	R411	R519	R727
Adults under food poverty line (R595pm)	**8.3m**	R26	R35	R46	R58	R84	R127	R198	R249	R349
CSG beneficiaries	**13.8m**	R43	R58	R76	R97	R139	R210	R328	R414	R580
Caregivers of CSG beneficiaries	**7.2m**	R22	R30	R40	R51	R73	R110	R171	R216	R302
SRD recipients	**6.5m**	R20	R27	R36	R46	R66	R99	R154	R195	R273

Source: Intellidex (2021)

"Social spending in South Africa achieved the largest reduction in inequality of 12 middle-income countries analysed."

While the range of possible combinations of eligibility and value is very wide, in practice, most proposals from civil society organisations appear to favour a grant that would cost in the hundreds of billions of rands a year. Thus, while the precise recommendation made by the Department of Social Development (DSD) panel is a little unclear, it appears to envisage that by 2030, all poor adults will receive a grant equivalent to the upper-bound poverty line (i.e. around R1,300 per month in today's rands) at a cost of about R400 billion per annum (Panel Report, p175). In the immediate term, however, they favour a lower valued grant targeted at a smaller number of people, favouring, at least initially, merely the extension of the current SRD grant but on the basis that it will be rapidly increased in value (Panel Report: 222). The Institute for Economic Justice (IEJ), on the other hand, have a different approach: they seek to estimate the maximum value of new taxes that might be imposed, and then establish what is the most generous combination of eligibility rules and grant values that could be afforded. They estimate that within three years, R280 billion a year in new taxes could be implemented, which could be combined with R50 billion a year in reduced waste in government (we will return to the realism of these estimates, below). This, they argue, would fund a BIG of about R320 billion a year, which would permit a grant of about R800 per month for all adults or of R1,250 per month for all adults who do not have formal employment (IEJ, 2021: 20)

Question Three: Doesn't South Africa already do a lot of redistribution?

South Africa is rightfully proud of the extent to which public policy seeks to ameliorate the effects of exceptionally high levels of income inequality that are a consequence of our catastrophically high levels of unemployment and inequality. However, precisely how much redistribution is achieved through public policy is difficult to measure, and depends on what one chooses to include and exclude because there are multiple channels through which redistribution occurs. It should be noted, however, that a great deal of aggregate redistributive effort channels income and assets to households that are not poor.

Redistribution through the budget

In the 2022 Budget Review, National Treasury provided a summary of total spending on the "social wage", a term that is defined to include all spending by government on the delivery of services from which poor households benefit directly, and includes everything from social grants to basic education, and from RDP housing to healthcare. Total annual spending on the 'social wage' exceeded R1 trillion for the first time in 2020/21, and accounts for about 52 per cent of all spending or 60 per cent of non-interest spending. It is also the equivalent of about a sixth of GDP.

Table 2: Spending on the "social wage": 2018/19 to 2024/25 (R billions)

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
	Outcome			Revised	Medium-term estimates		
Community development	**149,3**	**152,5**	**162,2**	**168,8**	**188,8**	**204,5**	**217,9**
Housing development	29,0	28,8	23,7	28,4	28,8	30,7	31,6
Transport	25,3	25,3	25,9	30,6	35,4	39,9	43,0
Water services	5,5	4,4	4,0	4,4	4,6	4,8	5,1
Local government[1]	89,4	93,9	108,6	105,3	119,9	129,0	138,2
Employment programmes	**19,6**	**21,6**	**19,1**	**21,6**	**24,8**	**25,3**	**25,9**
Health	**190,4**	**205,8**	**222,7**	**226,2**	**234,0**	**226,1**	**235,2**
Basic education	**223,9**	**239,3**	**247,6**	**260,7**	**266,7**	**265,9**	**275,0**
Higher education and training	**35,7**	**44,4**	**44,3**	**60,9**	**59,9**	**63,4**	**68,0**
Social protection	**186,9**	**217,0**	**247,8**	**255,0**	**276,1**	**240,7**	**253,1**
of which: Social grants	162,7	190,3	218,9	224,5	248,3	212,3	223,8
Social security funds	**55,0**	**51,9**	**105,7**	**82,3**	**71,1**	**59,7**	**51,6**
Total social wage	**860,7**	**932,5**	**1 049,4**	**1 075,5**	**1 121,4**	**1 085,6**	**1 126,7**

Source: National Treasury 2022

"Measured as a percentage of GDP, non-contributory transfers are more than three times larger than the average for the developing world."

A certain amount of care is needed in interpreting these numbers, however. On the one hand, it is true that, using the standard metrics deployed in assessing the redistributive effect of a country's fiscal policies, social spending in South Africa is much more redistributive than is the case in the developing world. Prof Nora Lustig and her colleagues concluded in a 2015 report, that the effect of a "mildly progressive" tax system and "strongly progressive" spending was that South Africa achieved "the largest reduction in inequality of 12 middle-income countries analysed" (Lustig, et al, 2015).

On the other hand, the method used to draw these conclusions is premised on the assumption that the value of the service provided to a poor household is accurately estimated by its cost. Thus, if it costs government R10,000 a year to educate a poor learner, then the value of the benefit to the poor learner is also R10,000 a year. While this is a plausible approach, the difficulty with it is that we know that the quality of basic education is (a) poor and (b) very unequal. We also know that teachers' salaries accounts for over 80 per cent of the cost of education, and that these have been rising much more quickly than productivity in the education system. It follows from this that, by using the cost of basic education (which is about a quarter of the social wage reflected in Table 2) to estimate the value provided to poor households, we are increasingly over-estimating redistribution: much of the increase in redistribution is not to learners from poor households, but to (non-poor) teachers.

Having said that, it is also clear that there is substantial redistribution achieved through the provision of social grants. Thus, in 2021, excluding beneficiaries of the SRD grant, some 18.4 million people were receiving some kind of grant, at a total cost of nearly R190 billion (Table 3).

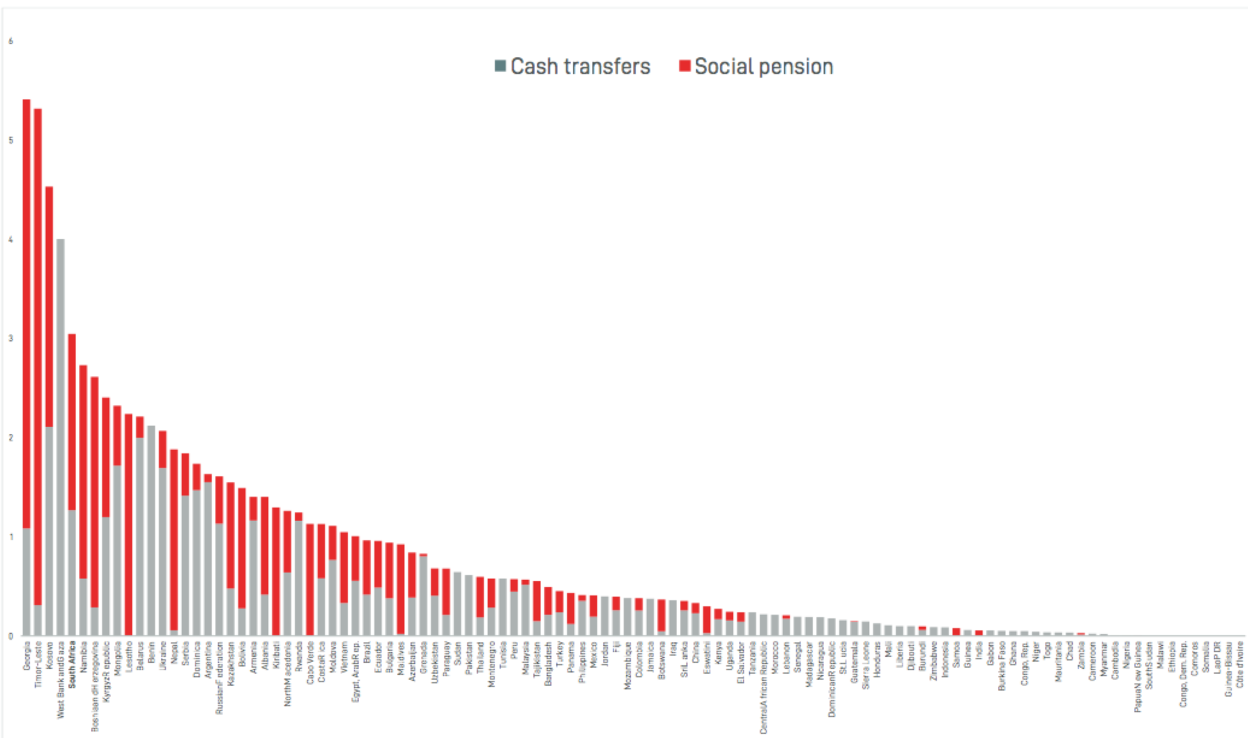
Table 3: Grants and beneficiaries: 2021

	Beneficiaries (million)	Rand pm	Total (million)
Child support grant	12,99	R460	R71 719
Older persons grant	3,72	R1 890	R84 430
Disability grant	1,00	R1 890	R22 629
Foster care grant	0,31	R1 050	R3 899
Grant in aid	0,27	R460	R1 479
Care dependency grant	0,15	R1 890	R3 405
War veterans grant	0,00	R1 910	R1
Total	18,44		R187 563

Source: DSD Panel Report 2021

By global standards, this level of expenditure on non-contributory social security is high: measured as a percentage of GDP, non-contributory transfers, at about 3 per cent of GDP, are more than three times larger than the average for the developing world (0.9 per cent of GDP). As a share of GDP, only Georgia, Timor Leste, Palestine and Kosovo provided more direct assistance to their populace, and the extent of non-contributory grants far exceeded efforts of other high-inequality countries like Brazil, Russia and Botswana.

Figure 2: Cash transfers to households as a % of GDP (2016 or nearest year)



Source: World Bank

Thus, even if we wholly discount the "redistribution" achieved through free (or near-free) basic education and healthcare, non-contributory pensions and unconditional cash grants mean that there is still a substantial amount of redistribution that does happen. Add the RDP housing programme to this, as well as programmes like NSFAS and the EPWP, land reform and free basic services, and the amount of redistribution achieved through the budget rises still further.

But these are not the only forms of redistribution that public policy seeks to secure in South Africa, and the off-budget redistribution plays a large, if unquantifiable, role in the redistribution of incomes, assets and opportunities.

Off-budget redistribution

Although on-budget redistribution is the primary means by which most governments seek to influence the distribution of income in a society, they also influence distribution to a greater of lesser extent using other policy instruments. In South Africa, these instruments include a plethora of rules going under the heading of "economic transformation". Some, but not all, of these are embodied in legislation, but all have the goal of shaping economic activity in the private sector in ways that promote the interests of specific constituencies deemed to be under-represented in the relevant domain (e.g. corporates' supply chains or their management or their owners). In addition, when it comes to public procurement (the annual value of which is in the order of R500 billion, if the SOCs and local government are included), there are distinct advantages accruing to firms that score highly in the measurements used to assess black economic empowerment.

There is no way to fully quantify the value of assets/income that has been redistributed through these measures, though a 2015 report by Intellidex that looked only at the BEE schemes of publicly listed firms, estimated that over R300 billion had been transferred to BEE beneficiaries in these schemes (Intellidex, 2015).

"The obvious concern with these programmes is that the redistribution that is effected does not benefit poor households."

The obvious concern with these programmes is that the redistribution that is effected does not benefit poor households. Indeed, the Intellidex study found that two-thirds of the value transferred through BEE schemes for listed companies accrued to "strategic investment partners", with only one third accruing to employee-ownership and community-based beneficiaries. The various rules, particularly as regards public procurement, have also created enormous opportunity for corruption and self-dealing that have been super-exploited by members of the political elite.

The bottom-line, then, is that South Africa does a great deal of redistribution, but many of the programmes that give effect to this are either inefficient and ineffective (e.g. the funding of basic education) or misdirected at non-poor beneficiaries (e.g. rules governing transformation) or prone to misuse and abuse (e.g. public procurement rules).

"Policies for which a society is unwilling or unable to raise the requisite taxes are unaffordable."

Question Four: Can we afford a BIG?

By far the most important question about a BIG is whether it is affordable. Obviously, the answer depends on how much it costs. Because there is no clarity on this critical question, discussion about affordability is a little complicated. Having said that, it is obviously the case that if a BIG were to make a significant impact on poverty, it would have to be expensive because of the sheer number of poor households and the obvious relationship between the value of a grant and the extent to which it raises households out of poverty. It would appear, therefore, that a discussion of affordability should be premised on the not-quite-explicit goal of BIG's proponents that it should be in the order of R200 billion a year, which would be the equivalent of about R800 per month for all working-age adults without formal employment. On this assumption, the answer to the question of a BIG's affordability is simple: no, it isn't.

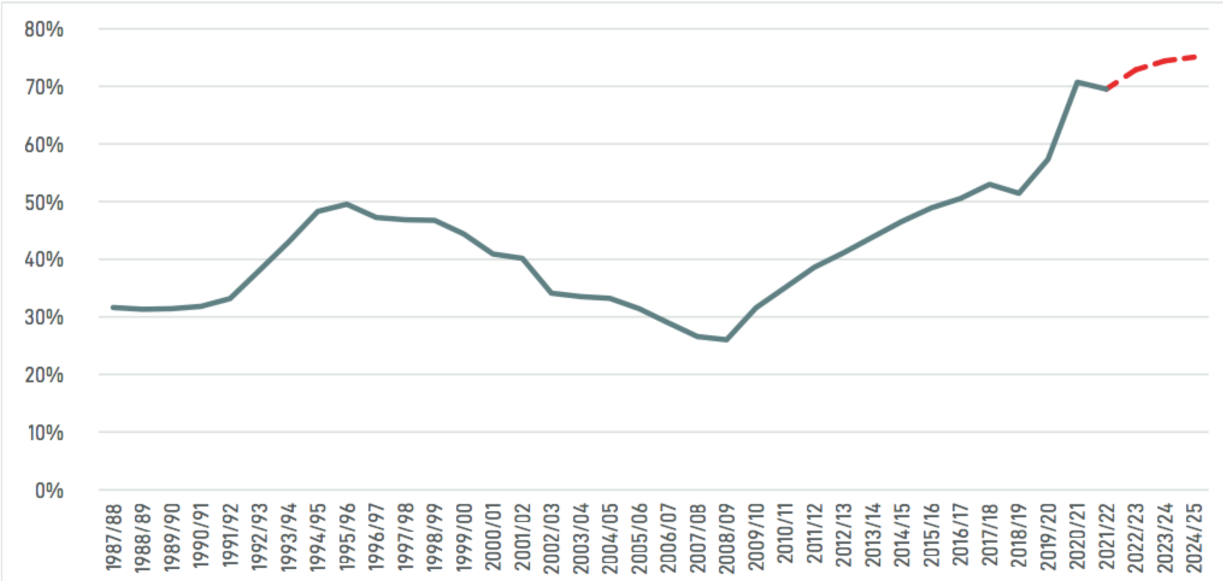
While a BIG of R200 billion a year would have a significant impact on household poverty, it would do so if, and only if, its implementation did not undermine macroeconomic stability or dramatically slow the rate of economic growth and job creation. Proponents of a BIG argue that the risks of this are somewhere between non-existent and manageable. But their analyses are fatally flawed.

What does "affordability" mean?

There is no unambiguous way to define affordability in relation to public policy: a society can afford all policies for which it is prepared to raise the taxes needed to finance them or if they are introduced in the context of a growth acceleration, and especially if they induce that acceleration. Of course, there are trade-offs because higher taxes means taking money away from households and, importantly, as taxes rise, economic growth tends to slow. Thus, if a society wants to implement an expensive new policy, it can do so if it is prepared to pay the price of higher taxes and/or slower growth.[2]

While it is not possible to define "affordable" unambiguously, it is possible to define what "unaffordable" means: policies for which a society is unwilling or unable to raise the requisite taxes are unaffordable. And the clearest evidence that policies are unaffordable is that the ratio of debt to GDP rises continuously. This can only happen, of course, if government's debt grows at a faster rate than GDP does. Using that definition, South Africa's current policies are unaffordable and have been since 2008.

Figure 3: General government gross debt as a percentage of GDP (1987 to 2024)



Source: National Treasury 2022

"A new spending commitment as large as the BIG would be unaffordable."

When the debt ratio rises as quickly as it has in South Africa over the past 15 years, it is a clear indication that the level of public spending exceeds the amount of taxes that government is willing or able to impose on society and/or that it is premised on over-optimistic predictions of economic growth. And, given the somewhat doubtful credibility of existing efforts to restrain spending growth – which rely very heavily on an implausibly long period of zero wage growth in the public sector – it would seem clear that a new spending commitment as large as the BIG would be unaffordable. Proponents of a BIG, however, do not necessarily agree.

The arguments of BIG's proponents

Three kinds of argument are deployed when BIG's proponents are pressed to explain how South Africa's over-stretched fiscus would pay for a BIG without its debt levels reaching a breaking point. These are:

- A BIG (especially if its implementation were accompanied by growth-enhancing reforms) would essentially pay for itself by stimulating economic growth and raising tax revenues so that, in combination, higher growth and more taxes would mean that the ratio of debt to GDP would not worsen and may even improve;
- A BIG could be fully financed by increasing taxes, and, therefore, would not worsen South Africa's debt ratio; and
- A BIG could be financed by the use of unorthodox monetary policies such as quantitative easing, direct lending to government by the Reserve Bank, and monetary financing of the deficit.

Can a BIG pay for itself?

An argument that is frequently made by proponents of a BIG is that its implementation would raise aggregate demand in the economy, stimulating economic activity, especially in sectors and sub-sectors that supply poor households. Financed through a combination of additional borrowing and new taxes, a BIG would actually boost growth and would not result in an increase in the debt ratio.

There are a number of difficulties with this view, the most serious of which is that it fails to recognise that the only way South Africa can stabilise its debt ratio is by running a primary surplus (i.e. government spending excluding interest payments must be less than its tax revenues). This is not an ideological position, but a mathematical certainty and it arises from the fact that the interest rate South Africa pays on its debt is higher than the rate of growth of the economy. If the opposite were true – as it is in most of the rest of the world – it might be possible to continue to run a primary deficit while stabilising the debt ratio. But this is not the case in South Africa, where growth is slow and falling and interest rates are high and rising.

"Higher taxes will slow economic growth."

The consequence of this mathematical certainty is that the only way a BIG that was not wholly funded by new taxes could fail to increase the debt ratio is if it raised growth so much that the growth rate exceeded the interest rate. But there is no theory of a demand-driven stimulus that could provide so strong a growth impulse. Indeed, given the scale of existing deficits, if deficit spending did induce such a strong growth response in South Africa, the economy would be booming already. In any event, it is far more likely that a BIG, by increasing the deficit, would lead to a rise in interest rates. If anything, in other words, the more likely outcome of implementing a BIG is not faster growth, but slower growth.

A tax-financed BIG would kill growth

Not all proponents of a BIG claim to believe that it will induce a growth impulse strong enough to prevent a rising debt ratio. The IEJ and the panel report of the DSD insist that the implementation of a BIG should be accompanied by an increase in taxes. Doing this, they argue, would mean that the primary deficit would not worsen as a result of the BIG, and so there would be no impact on the debt ratio.

This claim is also wrong because higher taxes will slow economic growth. In those circumstances, even an unchanged deficit will result in a rise in the debt ratio.

In a 2015 report, the Davis Tax Committee estimated that a R45 billion increase in taxes would necessitate increased tax rates that would reduce economic output by between 0.65 and 2.64 percentage points three years after its implementation. If that is the case, a fully financed BIG would still worsen the debt ratio because the economy would be smaller even if borrowing did not increase. Importantly, the Davis Tax Committee's estimate of the negative effect of an increase in taxes is likely to over-estimate the effect of higher taxes if they are used for a BIG since the additional spending by poor households will offset some of the decline in aggregate demand associated with higher taxes. Still, even the DSD panel report concludes that higher taxes will slow economic growth even after taking into account the stimulatory effects of increased spending by poor households.

There are, in any event, real doubts about how easily R200 billion could be raised in new taxes given the already-high level of taxation and the weakness of the economy, notwithstanding the temporary boom in taxes from the mining industry and financial services. In this regard, the 2021 report by Intellidex into the sustainability of a BIG and the report of the DSD's expert panel are both highly critical of the IEJ's tax proposals.

In its 2021 report, the IEJ proposed a series of measures that would generate, so they claimed, up to R330 billion in additional revenue per year within three years. The most important components of this number were:

- R66 billion in additional personal income taxes plus a further R30 billion in reduced deductions claimed for contributions to pension funds and medical aids
- R59 billion from a new wealth tax
- R50 billion reduction in wasted and irregular spending in government, and
- R38 billion in a "resource rent" tax on mining companies

"The IEJ's proposals appear to be impractical and would not raise the anticipated amount of new taxes."

Apart from the fact that imposing a tax shock as large as this would be enormously destabilising and would have very negative implications for growth, both Intellidex and the DSD's panel identify numerous problems with these proposals when they are examined on their own merit. The IEJ's proposal for a resource rent tax, for example, appears to be premised on a misunderstanding of the way that the World Bank calculates resource rents, and simply assumes that these are available as untaxed profits of mining companies. The IEJ also makes no allowance for interdependencies of various taxes: it assumes, for example, that raising a resource tax (even assuming their interpretation of the concept was accurate) would have no impact on either company profits or on personal income. Nor does the IEJ anticipate that the vast increase in personal and wealth taxes would impact on household spending and, therefore, on VAT collections. In addition, the proposal to reduce wasted spending and to shift that towards a BIG, has no substance other than wishful thinking about where, whether and how savings of this kind might be identified.

The upshot of this is that the IEJ's proposals appear to be impractical and would not, in fact, raise the anticipated amount of new taxes. More fundamentally, however, the IEJ's approach makes absolutely no allowance for the highly probable, strongly negative impact of a large tax shock on South Africa's growth rate.

Paying for a BIG by printing more money would be a disaster

The most radical proposals for the financing of a BIG are made by adherents of modern monetary theory (MMT), a faddish theory that holds that countries that issue debt denominated in their own currency cannot face fiscal crises, and that, as a consequence, their governments can spend as much as they like with the only constraint being the availability of real resources (workers, physical capital, natural endowments, etc.). When governments run up against these constraints, inflation will rise, but, to control that, all they need do is reduce spending and borrowing. In these models, there is no essential difference between borrowing money from the private sector, borrowing it from the central bank or simply printing more. For MMT-inspired proponents of a BIG, there is, therefore, no reason to worry about financing: the Reserve Bank can print all the money that's needed or can lend it to government at arbitrarily low interest rates.

These are exceptionally misguided views.

Were some version of an MMT strategy applied to pay for a BIG, it would represent a fundamental departure from the current role of the Reserve Bank, which is charged with maintaining the value of the currency, and which uses a variety of policy tools to manage this. Instead, its policies would be dictated by the financing needs of government. Inflation would be inevitable, and, in these circumstances, it would no longer be possible for government to find lenders willing to extend loans denominated in rands, except at punitive interest rates, so the Reserve Bank would have to lend money to government or, which is equivalent, print more. Even by the logic of MMT, this is bound to be inflationary in a society in which critical resources are scarce. While this does not apply to unskilled labour, it certainly does apply for a wide range of other essential inputs into the production process including skilled workers, electricity, logistical services. Running up against these limits mean that monetising a deficit will not spur growth but will accelerate inflation.

Question Five: Could a BIG be part of a package that induced more rapid economic growth?

The bottom line conclusion of the previous sections is that the introduction of a BIG would be unaffordable. Adding an unfunded BIG (even if it is only partially unfunded) to existing spending commitments without raising sufficient taxes to pay for it, must inevitably increase the rate at which the debt ratio rises. Conversely, if a BIG were fully funded through an increase in taxes – a big if, given the implausibility of the IEJ's proposals – it would not increase government's borrowing requirement, but it would lead to slower growth. Thus, even if a BIG's introduction did not raise government's borrowing requirement and left the deficit unchanged (because the cost of the BIG is offset by increased taxes), the resulting deceleration of economic growth would mean that the debt ratio will climb more quickly than it is already.

Given this conclusion, it is worth thinking about a BIG as part of a package of reforms that might induce faster growth. This, in essence, is the proposal made by Colin Coleman in two op-eds, one co-authored with Nouriel Roubini and Pramol Dhawan.[3] His argument is that South Africa's economy is stuck in an "unstable disequilibrium" characterised by high unemployment and inequality, what he calls "uncomfortable" fiscal deficits and debt ratios, and an absence of effective reforms. The "real problem" he insists, is the absence of growth, the resolution of which would make possible rapid improvement in the other dimensions of the "disequilibrium."[4]

"Coleman says that old-style austerity combined with structural reforms will fail to kick-start the economy."

Though Coleman repeatedly stresses the importance of "structural reforms" for accelerating growth, he also says that "old-style austerity" combined with structural reforms "will fail to kick-start the economy", and that "South Africa needs to rethink economic policy and stimulate an inclusive growth path." This would "transform the economic growth trajectory akin to the country adopting a coherent business plan and drive investment to equitise (sic) its sheet."

Although Coleman advocates for a number of reforms and interventions that would facilitate growth, the keystone of his proposed strategy is the implementation of an R800 per month grant for South Africa's unemployed adults. This would cost around R110 billion a year, or about 2 per cent of GDP. The grant, he says, "should be a multiyear, if not permanent, successor to the R350 per month social relief of distress grant", but would be "more than twice its size and reaching almost twice the number of recipients over a number of years." The grants, he assures us, "will be spent back into the economy, and have a multiplier effect on stimulating economic activity and jobs."

> **"This is one of the most problematic claims made by proponents of a BIG: that it would stimulate economic growth."**

On the question of how this would be financed, Coleman offers that the grant "may be paid for in part by some government saving measures and tax reforms such as removing deductions targeted at high-income taxpayers. Nevertheless, in the short term it will require about R100 billion of additional debt on the government's balance sheet", a figure, he says, that is "roughly equal to anticipated incremental South African corporate tax revenues this year [2021/22] from the commodity boom." The boom, he assures readers, will persist for some time to come, a view that is very far from a mainstream consensus.

These assertions are not convincing. It is unclear how a new grant costing in excess of R100 billion per year will add a total of only R100 billion in total to public debt. To do so, the grant would have to be more or less fully funded through increased tax revenues (whether through increased tax rates or induced by faster economic growth) or reduced government spending within a year or two of its implementation. Coleman offers no guidance as to how he thinks this will be achieved, though he has elsewhere expressed a very strong view that South Africa cannot afford to increase tax rates.[5] One should assume, therefore, that the principal approach to financing the grant must be growth-induced increases in tax revenues rather than raising the rate at which taxes are levied on existing income. He offers no details about his calculations and what would have to be true for a BIG to add only R100 billion to South Africa's debt stock, but if it is true that he expects growth to drive this, his assessment of the multipliers involved must be implausibly large: if taxes remain at about 25 per cent of GDP, the only way an expansion of annual public spending of 2 per cent of GDP could pay for itself is if it and the reforms he contemplates would increase GDP by 8 percentage points over a short period of time if the aggregate increase in net debt is to be limited to R100 billion. That would imply a multiplier of something like four. This is about three times greater than even the most optimistic assessments of South Africa's fiscal multipliers, and both the Reserve Bank and National Treasury have said that they think the true value of the fiscal multiplier is close to zero.

Whether or not Coleman is simply making a mistake with his numbers, the underlying logic of his argument is the same as that of many others': notwithstanding government's repeated warnings about the precariousness and unsustainable character of the public finances, it should spend more to stimulate growth, and that the induced-growth will, retrospectively, justify the decision to increase spending by ensuring that the ratio of debt to GDP does not worsen. This claim is wrong and there are a lot of reasons for thinking that a BIG will not raise growth rates.

This is one of the most problematic claims made by proponents of a BIG: that it would stimulate economic growth. This issue has been partially covered in the previous section, but it is important to state as clearly as possible that the claim is implausible.

The principal reason for saying so is that South Africa's growth deceleration is not the result of a deficiency of aggregate demand. Instead, it has deeper and more structural roots than an "ordinary" recession. The country's growth crisis has its origins in the collapse in governance after 2008, a plethora of regulations that raise the costs of doing business, the lack of available power generation capacity, deep concerns about the future trajectory of governance and of policy, and the flight of skills and knowhow. These are just a few of the major constraints on growth, none of which would be in any way ameliorated by higher levels of household spending as a result of a BIG. In the face of these real constraints, a BIG would raise beneficiaries' consumption but at the cost of reduced consumption elsewhere, while overall levels of economic activity would be, at best, unaffected. That is the best case scenario. In all likelihood, however, overall levels of economic activity would fall for the reasons articulated above: a BIG would either accelerate the rise of the debt ratio (which is already a constraint on growth) or it would require the introduction of more taxes that would themselves slow growth.

But what if the introduction of a BIG were accompanied by reforms that accelerated growth? Would that make the BIG affordable?

"There are no easy answers to what to do about poverty rates as high as South Africa's."

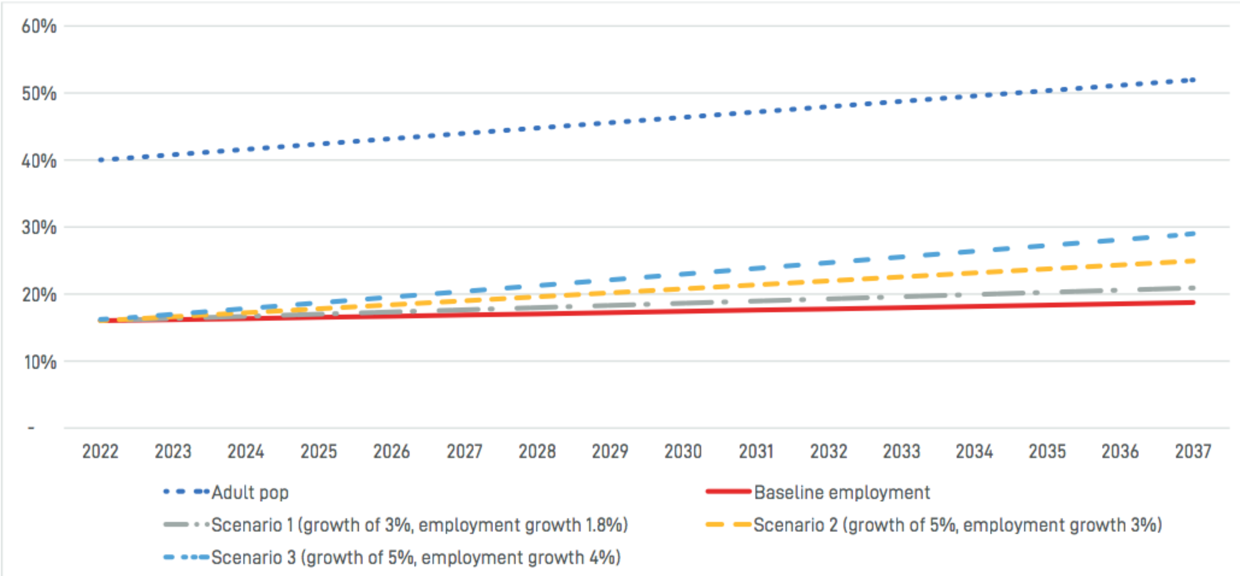
In principle, it is of course true that faster growth would make more government spending affordable, and CDE has always argued for policy reforms that would stimulate growth. There is, however, an important problem with linking the implementation of these reforms: because the introduction of a BIG is more likely to reduce growth than raise it and its introduction with other reforms would dilute the impact of these reforms, making them less likely to gain traction. Indeed, by undermining the credibility and sustainability of macro-economic policies, a BIG would make it less likely that any set of reforms would induce the growth that would be needed to fund the BIG itself. The BIG, in other words, would not facilitate faster growth, but would undermine it further. To the extent, therefore, that a BIG is to be implemented, it should be introduced after growth rates have been raised, not before.

Question Six: What alternatives exist for reducing poverty?

Perhaps the hardest question to answer in relation to the call for a BIG is what are the alternatives. There are no easy answers to what to do about poverty rates as high as South Africa's and the truth is that there are no short-cuts. Indeed, even under optimistic assumptions, it will be difficult to create employment fast enough to raise employment levels from around 40 per cent of working age adults to the global norm of approaching 60 per cent.

Consider, in this regard, Figure 4 below, which shows how the number of working age adults is likely to rise over the next 15 years, as well as four scenarios for employment growth. The baseline assumption is that employment grows over the next 15 years at the same rate as it grew between 2008 and 2020 – just over 1 per cent a year. Under that scenario, the employment ratio will fall even as the number of employed people rises to around 19 million because the adult population will grow faster than employment will. Scenarios one, two and three show what happens if the economy grows at different rates (3 per cent a year for scenario one, and 5 per cent a year for scenarios two and three), with the first and second scenario also assuming that the rate of growth of employment is 60 per cent of the rate of economic growth, while the third scenario assumes that employment growth is 80 per cent of the rate of economic growth. Only under the last scenario does the percentage of adults working rise to 55 per cent, with figures of 40 per cent and 48 per cent for scenarios one and two, respectively.

Figure 4: Employment growth scenarios



Source: CDE

> **"In the context of already-unsustainable fiscal policies, the costs of a BIG are bound to make our economic challenges even harder to resolve."**

The trouble is that even the assumption that employment grows at 60 per cent of the rate of economic growth can be thought of as optimistic for an economy where the employment ratio is only 40 per cent, which would imply that the incremental increase in GDP from each year's economic growth would have to be 50 per cent more employment-intensive than the average for the existing economy. Further, assuming that employment grows at 80 per cent of the rate of economic growth would imply that incremental additions to GDP were twice as labour intensive as the current economy. Any prediction that employment will rise to something approaching the international norm, in other words, requires either rapid economic growth or growth that is much more labour-intensive than the current economy – growth, in other words, that is in sectors that are much less productive than the current economy. With the best possible will, this would be very difficult to achieve, but the will is also lacking: our policies are generally very unfriendly to growth and there seems to be little appetite in the ruling alliance (or, indeed, among proponents of a BIG) to contemplate policies that would raise the labour intensity of growth. If anything, the constant pressure is to force up the cost of employment which makes low-productivity activities less commercially viable.

It is these hard realities that help explain why the idea of a BIG has gained such traction: slow growth combined with policies that seek to make low-productivity activities less viable have meant that employment growth has lagged population growth leading to more and more unemployment.

But, in the context of already-unsustainable fiscal policies, the costs of a BIG are bound to make our economic challenges even harder to resolve, slow our growth even further and set us irretrievably on a path to fiscal crisis. As argued above, if the growth rate is lower than the interest rate, it is mathematically impossible

"Getting faster growth requires, first and foremost, a credible pathway back to sustainable public finances."

to avoid a rising debt ratio unless government runs a primary surplus. Even a fully funded BIG will do no more than prevent the primary deficit from widening even as it slows growth and raises interest rates. The inevitable consequence will be a fiscal crisis that could easily morph into a financial crisis by undermining the solvency of South Africa's banks and financial institutions who hold government debt as an asset. This would be a disaster for all, especially the poor.

That there is no magical solution to the enormous challenge of poverty does not mean that there is no solution. Poverty can be reduced. This will require determination and boldness and an approach to economic growth that is different from what we have today. The focus has to be on employment creation and poverty reduction which means the strategy must be one that:

- Maximises growth,
- Ensures that growth is as labour-intensive as possible, and certainly more labour-intensive than the current economy, and
- Improves the efficiency and effectiveness of all redistributive spending in the economy, while ensuring that that spending does not itself undermine growth.

Maximising growth

The most important component of the solution to our challenges is faster growth, the benefits of which would include: more jobs, higher levels of tax revenue (with a resulting reduction in the fiscal deficit), and a reduction in the differential between economic growth and the interest rate (which would help make government's borrowing requirements more sustainable).

Getting faster growth requires, first and foremost, a credible pathway back to sustainable public finances, the unsustainability of which weighs down on the economy through increased uncertainty, lower investment levels and higher interest rates. As argued a BIG, unless accompanied by offsetting cuts in other forms of spending, runs directly counter to this.

In addition to fiscal sustainability, we need to make much faster progress in overcoming the hard constraints on growth – especially the lack of electricity generation and skills. We also need much more market-friendly policies that lower the cost of doing business and help raise levels of investment. There has been some modest progress on some of this in the past 18 months, but much deeper, more far-reaching reforms are needed. As much as anything else, government needs to work hard to show that it is supportive of business and that it understands that its role is to create an enabling environment for this. **Words, sadly, are not enough nor are good intentions: what is required is action across a range of policy dimensions to provide the requisite environment.**

Above all, government needs to address the collapse of governance that we have endured over the past 15 years. Unless and until the threat of return of the corruption and lawlessness experienced under Jacob Zuma is eliminated, there is little chance of sustained economic growth.

The state-owned companies, whose functioning has been so severely compromised through state capture, and whose grossly inadequate performance and expense undermine our growth today and our growth prospects for the future need to be thoroughly rethought.

Increasing the labour-intensity of growth

As a general proposition, most current government policy ideas have as their goal the promotion of more activity in high value-add sectors, where conditions of employment are good and where high productivity supports high wages. While these interventions, when they work, are good for the relevant beneficiaries (though they may impose costs on others), by its nature, a policy preference for high value-add activities implies that low-productivity – i.e. more labour intensive – activities are being, at best, disfavoured. Given the intuitively obvious link between high levels of unemployment and poverty, this is a mistake.

The two exceptions to the general rule that government has a revealed preference for activities that are less labour-intensive than for activities that are more labour-intensive are (a) the employment tax incentive and (b) the various components of the expanded public works programme. Both of these should be expanded as quickly as a possible, but at a rate consistent with maintaining fiscal sustainability.

"Government needs to grasp the nettle of labour market reform."

More importantly, government needs to grasp the nettle of labour market reform. Both South Africa's employment law and its wage-setting systems create onerous demands, especially on small and new businesses. Addressing the needs of these businesses for a more accommodative labour market regime has the potential to spur employment creation, especially for the unskilled workers whose labour is more likely to be demanded by small firms than by large ones.

Improving the efficacy of redistributive spending

South Africa's system of social grants, while lacking coverage for able-bodied, working-age adults, is otherwise well-designed, efficiently providing meaningful support through well-targeted grants. The efficacy of the rest of spending on the system providing various components of the "social wage" is much more dubious, with the efficiency and effectiveness of the public education and healthcare systems being particularly problematic. It is well past time to fix these broken systems, or to develop alternative delivery mechanisms through public private partnerships or some other means.

Hard questions also need to be asked of the costs and benefits of "off-budget" redistribution. The various laws, regulations and charters that define the role of broad-based black economic empowerment in South Africa have raised the costs of doing business. No doubt, it has achieved a measure of success in its own terms, though it is much less clear how much that change would have happened anyway. In the meantime, the costs of these policies (a figure that includes the regulatory complexity that these rules have created) have slowed economic growth and, therefore, job creation. Again, it is well past time for disinterested enquiry into the costs and benefits of these policies.

Concluding remarks

The extent of South Africa's many crises – poverty, growth, poor governance, increasingly fractious social and political relations – means that there are no easy answers to the challenges we face. While a BIG appears at first glance to offer some prospect of improving the lot of the many millions of people who live in poverty, its costs, when combined with the already-unsustainable level of public spending, will make it far harder to pull the economy out of the hole into which we have dug ourselves.

South Africa's approach to its crises is to commit ever-more resources to compensating people for their exclusion from the main currents of social, political and economic life. This is not a sustainable response and will result in the permanent exclusion of many millions of people.

The only plausible answer to our challenges is sustained growth that is as rapid and as labour-intensive as possible. The current policy mix will not deliver this, and a resort to a BIG should be seen as the desperate move that it would be. South Africa needs cool-headed leadership to take on our policy challenges. A BIG would be a reckless, losing gamble with history.

Endnotes

[1]It is important to say that it is not entirely obvious that the income of a poor household rises by the exact amount that they receive in the form of a grant. If, for example, a household was receiving support from another household – a relative with a job, say – then the introduction of a BIG might be followed by a withdrawal of some or all of the inter-household support previously provided. In these circumstances, the true beneficiary of the BIG is not the household that receives it, but the household that is able to reduce its support to its poorer relatives.

[2]Money is fungible, of course. A policy can be paid for without raising taxes if its introduction is accompanied by cuts to other kinds of spending.

[3]Coleman, C (2021a) "SA doesn't have a debt problem, it has a growth problem – and a solution" In Sunday Times 3 October 2021 available at https://www.timeslive.co.za/sunday-times/opinion-and-analysis/2021-10-03-sa-doesnt-have-a-debt-problem-it-has-a-growth-problem-and-a-solution/

Coleman, C, Roubini, N., and Dhawan, P. (2021) "How to put SA's economy on a bold, sustainable and inclusive growth path" in Sunday Times 17 October 2021, available at https://www.businesslive.co.za/bd/opinion/2021-10-17-how-to-put-sas-economy-on-a-bold-sustainable-and-inclusive-growth-path/.

[4]It should be noted that Coleman's columns sparked highly critical responses by a number of commentators, including Thabi Leoka, Isaah Mhlanga and Claude de Baissac. See https://www.timeslive.co.za/sunday-times/opinion-and-analysis/opinion/2021-10-10-coleman-is-wrong-sa-cannot-afford-more-debt/ , https://mg.co.za/opinion/2021-10-05-social-welfare-investment-not-debt-taxation-and-consumption/, https://www.businesslive.co.za/bd/opinion/columnists/2021-07-22-isaah-mhlanga-basic-income-grant-is-like-a-bandage-on-a-broken-bone/ , and https://www.businesslive.co.za/bd/opinion/2021-10-21-claude-de-baissac-a-strategy-guaranteed-to-fail/. claude-de-baissac-a-strategy-guaranteed-to-fail/.

[5]Coleman, C. (2021b) "Three-pronged strategy will help SA to bounce back" in Business Day 21 July 2021, available at https://www.businesslive.co.za/bd/opinion/2021-07-21-three-pronged-strategy-will-rescue-sa-from-a-shaky-future/

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5 Eton Road, Parktown, Johannesburg 2193, South Africa | PO Box 72445, Parkview, 2122
Tel +27 11 482 5140 | info@cde.org.za | www.cde.org.za